

Mortgages and Pledges in Contemporary Islamic Commercial Law: A Study of Their Application

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ABSTRACT

In the realm of economics and finance, which deals with monetary matters, Islamic principles guide financial activities in accordance with Sharī'ah law. While profit generation is permissible in Islam, it must align with ethical guidelines. Unlike conventional systems that often rely on ribā (interest) and exploitative practices, Islamic finance promotes compassion, community, and the fulfillment of needs. Ribā is viewed as an unjust mechanism that concentrates wealth and denies fundamental rights to the masses, with Islamic economics aiming for equitable wealth distribution.

Security in financial transactions is crucial, as it fosters trust and ensures the performance of obligations. In Islamic commercial law, the concept of rahn encompasses various forms of collateral, including pledges and mortgages, to safeguard against default. This system allows lenders to extend interest-free loans with confidence, as it supports societal welfare. Rahn operates under specific rules and principles that protect both creditors and debtors, preventing any party from taking undue advantage. Islamic financial institutions offer Sharia-compliant products, including rahn, which serves both as a security mechanism for transactions like Murābahah and as an independent offering.

This article explores the mortgages and pledges provided by Islamic financial institutions, with an emphasis on the regulations set forth by the Accounting and Auditing Organization for Islamic Financial Institutions concerning pledges. It explores the application of rahn across various products and its role as a standalone offering, particularly in Islamic pawn broking. Additionally, the article delves into the Islamic mortgages and home financing schemes available through these institutions, highlighting their unique features and compliance with Sharī'ah principles.

Keywords: Mortgage, Pledge, Security, Rahn, Sharī'ah, Murābahah, AAOIFI, Pawn broking, Bay' mu'ajjal, Ijārah

1- PRINCIPLES GOVERNING “RAHN” FOR ISLAMIC FINANCIAL INSTITUTIONS

In credit transaction contract according to *Sharī‘ah* Standards no.5 the parties to the contract may with mutual consent stipulate that the customer will provide a pledge to secure the expense of the commodity to the creditor or bank or financial institution.¹ Possession of pledge asset will be delivered to the creditor as according to the rule but such possession will not prevent him from demanding payment of price/debt when it became due.²

Islamic financial institutions may demand a pledge of security because it is lawful to take security of loan to secure repayment of debt.

As mentioned by Allah in Holy *Qur’ān*:

“If you are on a journey, and cannot find a scribe, a pledge with possession may serve the purpose”.³

It gives confident and trusts to the creditor that his money would not be lost and he will still be able to recover his payment in case of default on part of debtor. Practice of the Holy Prophet (P.B.U.H) also shows its legality. Holy prophet (P.B.U.H) died and at that time his shield was held as security for a mortgage.⁴

Contract of *rahn*/pledge is logical, it encourages the creditor, to give debt and also the debtor to payback the debt and hence, keep both parties at safe position.

The pledger or debtor cannot revoke the contract once entered into it but pledgee in this case Islamic bank etc can disclaim or reject his right to pledge, so this contract is binding on the debtor /client but not on the pledgee or financial institution.⁵

The nature of the contract is binding for the debtor or pledger, who is owner of the pledge asset. He cannot revoke the contract even if the asset is in his possession but it will remain optional for the pledgee or Islamic bank until he receives the possession of the pledge asset. Basically, this contract is made to facilitate the pledgee creditor that’s why his acceptance is very important.

The pledge property is used to recover the debt in case of non-payment so it is important that the property must have a material value in the eye of law. It can be legally owned, sold, identified by sign, description, name and able to deliver and possessed.⁶

Pledge asset is owned by the pledgee or debtor, if a person has a share in joint property, he can pledge his share of property but with a condition that percentage of pledge asset must be specified in the contract.⁷

More than one pledge can be given on the same property. The subsequent pledgee must be aware of previous pledges. Date of registration

of pledges determine the rank of creditor pledgee in respect of recovery of their debts from the pledge assets.⁸

The pledge asset is the ownership of pledger as well as the act of pledging it to secure the payment of debt or performance of promise will not deprive him from its ownership. Delivery of possession to the pledgee is very important in contract of pledge due to the fact, that it make possible for the creditor pledgee to recover his payment in case of default on the part of the pledger. There is no hard and fast rule by which, possession of a thing can be delivered, it varies according to the nature of things or articles. According to *Al-Shirbīnī*, the term “possession” is used but it is not defined or explained by the lawgiver, so recourse must be to the customary practices.⁹

Customary practices play an important part in determining the method of delivering possession of property. Property includes: movable and immovable, movable property may easily be possessed by actual or physical delivery. Constructive or legal delivery of possession may take place in movables and immovable, according to the nature of the transaction and customary practices. Delivery of possession does not mean that it must be physically delivered to the pledgee. It may be delivered actually and constructively. Pledge property may remain in the possession of pledger or debtor and all the rules of a valid pledge will be applicable on such a pledge and it is called “security” or “registered pledge”.¹⁰ Such possession of pledge property is considered “constructive possession” and hence, recognized. Likewise, the possession of document of title deed and key of a warehouse where pledge asset is stored or delivered etc, are examples of constructive possession of pledge property.

Mortgage of immovable property, pledges and hypothecation of movable property like trains, streamers, airplanes or cars etc., may be legally and validly possessed through registration.¹¹ There is no need to actually or physically deliver the possession of movable or immovable property, where it is practically impossible to deliver its possession or there can be any other reason for it, then “registration” considered actual possession and stands in place of it.

It is not necessary that the debtor can pledge his own property only. It is permitted that he may pledge the property of any third person with his permission and this is called “borrowed pledge”.¹² Pledge property may be entrusted to a third person called an “‘adl”¹³ and property remains a trust in the hand of ‘adl

Under the law, the pledger retains ownership of the pledged asset, meaning any decrease or harm to the asset, as well as every benefits or increase arising from it, belong to the debtor. This rule is outlined in this *ḥadīth*:

“Accession and loss belong to the pledger”.¹⁴

The pledgee detains the pledged belongings like an amanah and he is not liable for some defeat and reduction in its value, provided the loss did not occur due to his own fault or negligence.¹⁵ Allah says in this verse:

فَإِنْ أَمِنَ بَعْضُكُم بَعْضًا فَلْيُؤَدِّ الَّذِي أُؤْتِنَ أَمَانَتَهُ وَلْيَتَّقِ اللَّهَ رَبَّهُ

“And if one of you deposits a thing on trust with another, let the trustee discharge his trust, and let him fear his Lord”.¹⁶

In this case, the property owner, known as the pledger, is responsible for every cut or harm to the possessions. However, if the pledged asset is destroyed due to the mistake or carelessness of the pledgee or a third party in custody of the asset, they will be liable for the loss. As the pledged asset is considered a trust in their care, they must compensate the owner for any resulting damage or destruction.¹⁷ Prophet Muhammad (s.a.w) stated:

“The security is a trust in the hands of a pledgee”.¹⁸

Therefore, creditor pledgee is trustee and pledge asset is trust in his hands, if the property is in the hand of some third person (*‘adl*), he will also consider as trustee. They are not held responsible for any loss or destruction occurred to the pledge property devoid of their carelessness or fault. All the loss will be borne by the owner (pledger). If the damage or destruction is due to the negligence of the pledgee or *‘Adl*, they shall be responsible to compensate the owner.

Any increase in the value or yield of the pledged asset, such as fruits, offspring, or wool, rightfully belongs to the owner and not the pledgee. This principle is supported by *hadīth*:

“Pledge is for the debt”.¹⁹

Every augment or growth in pledged asset remains the pledger's right, not the pledgee's. While possession is transferred through the pledge, ownership and title remain with the pledger, who is answerable for every hurt or harm to the property, as well as entitled to its benefits. The pledgee can use the property's growth to cover maintenance expenses, which are the pledger's responsibility. In the event of default, any surplus from the sale of the pledged asset, after debt recovery, also belongs to the pledger.

2- RAHN AS A SECURITY/GUARANTEE IN OTHER PRODUCTS

Islamic financial institutions utilize “*rahn*” like a security for different goods and services, offered by them. It works as additional or complementary transaction and occupy an important place in the financial market. Economic and financial activities need finance and financier is all

the time, looking for guarantee to secure his money, from being drawn. *Rahn* or security plays an important role by securing the amount of advance or debt from being default. Spot as well as credit transactions are also very popular in the financial market. There are many products currently; available in Islamic financial market, in which *rahn* is used to secure the transaction.

I. SALE ON DEFERRED PAYMENT BASIS (BAY‘MU’AJJAL)

In *Bay‘mu’ajjal* the payment of price of the commodity is deferred with the consent or agreement of the parties.²⁰ Price of the product become debt and seller is permitted to take security from buyer to protect the payment of debt. Security could be in the form of a mortgage or lien or a charge on his property.²¹ Here purpose of security is to facilitate the transaction, so the seller is confident that his money would not be wasted, returned back to him.

II. MURĀBAHAH

In *Murābahah* transaction the seller is entitled to ask for security, to secure the payment of “*Murābahah* price”. Security will give him trust and confidence that his money would not be destroyed or lost. Seller may ask the buyer in *Murābahah* sale contract, to furnish a security in the form of mortgage or a pledge or lien.²²

In the practices of Islamic banks, they take advance payment from its client that is called “*urbūn*” and such amount is deposited in an account, until the commodity is purchased by the bank for its client, and delivered the possession.²³ According to the *Fatwa* Advance payment is held as guarantee by the bank for the payment of the *Murābahah* contract.²⁴ Client pays the price of *Murābahah* contract in installments and *urbūn* (advance) money is used to secure the payment of contract price. *Urbūn* can only be taken at the time of concluding the contract and any advance amount that has been taken by the bank before the conclusion of the contract will be treated as a trust, in the custody of seller/bank, till the time of contract, then it will become a part of price. After the conclusion of contract that advance money will be served as pledge/*rahn* for the installments of the *Murābahah* contract price.²⁵ Cash amount of money may become the subject of pledge. It is permitted under Islamic law to take the pledge of cash amount with the condition that it must not be used by the pledgee.²⁶ Use of pledge asset by the pledgee is forbidden and considered *ribā*. The seller while asking for security in the form of mortgage/lien/charge/pledge must keep in mind that security is used to secure the payment of debt or performance of price.²⁷ There must be an existing relationship of debtor and creditor between the parties, when commodity of *Murābahah* contract has been sold by the seller and price become due on buyer.²⁸ Mortgage may be taken at the time when price of *Murābahah* contract is determined; mortgage asset will be held at the

responsibility of seller, any loss or destruction of the asset before the actual sale of the commodity will be compensated by the seller.²⁹ Bank or financial institution can also sale the collateral without recourse to the court, at the event of default.³⁰ Security or collateral is not proved to be a best solution specially, in the case of bad debts, because it has many practical problems.³¹ Pledge property is security, pledgee, mortgagee or charge-holder are not permitted to get any financial benefit from such property.

III. MUSHĀRAKAH, MUDĀRABAH, IJĀRAH, SALAM AND ISTISNĀ‘

In *Mushārahah* contract, the partner may ask to furnish a pledge of asset to cover the cases of negligence, misconduct or breach of contract by the other partner.³² *Mushārahah* capital is trust in the hands of all the partners. One partner is not permitted to give security to secure the capital of other partner. Guarantee may only be taken to cover the cases of misconduct or negligence on the part of the other partner.³³

In *Mudārabah* contract, the institution or capital provider may ask to furnish a pledge of security to cover the cases of negligence, misconduct or breach of contract by the *Mudārib* only.³⁴

Pledge of movable or personal guarantee or both types of securities, may be taken by the seller in Salam transaction.³⁵ Bank can sell the pledge movable to satisfy³⁶ his claim from sale proceeds, if buyer commits default. Any Excess amount from sale proceeds that is over and above the debt/price will be given back to the owner/pledger.

In *Salam*, *Ijārah* and *Istisnā‘* contracts, a pledge of an asset, to secure the payment of price of commodity or rentals etc., from being default by the buyer/debtor or lessee, may be taken by the seller or lessor.³⁷

Movable or immovable assets may become the subject of *rahn* or pledge or mortgage. Many other products are discussed by AAOIFI, in which price of contract may be secured by way of “*rahn*” or other forms of guarantee may also be taken.

3- MORTGAGES

3.1- ISLAMIC MORTGAGES

Usury is absolutely prohibited in *Sharī‘ah* law and any deal involving usury is likewise not allowed, as emphasized by this *Qur’ānic* verse:

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا الرِّبَا أَضْعَافًا مُضَاعَفَةً

“Devour not usury, doubled and re-doubled”.³⁸

People in the world at large fulfill their needs with money and some people do not have enough money to satisfy their needs. House or shelter is one of the basic necessities of human being. People naturally, want to get their own houses and try to avail all the opportunity, to meet this desire. Needy or those, do not have enough cash to buy a residence, go for mortgages to fulfill their need of advance/loan.

Numerous mortgage markets worldwide offer conventional interest-based mortgages to meet the demand for home financing. In western countries like United Kingdom, United States, Canada etc., conventional mortgage markets are very huge and catering large number of people. Conventional mortgages are interest-based and interest is prohibited in Islam. Muslims may not take those mortgages because they are against their faith. Islamic financial institutions have introduced their own Shari'ah-compliant mortgage solutions to cater to Muslims, particularly in Western countries. Currently, *Ijarah*, *Musharakah*, *Murabahah*, and *Mudarabah* mortgage models are available within these institutions.³⁹

3.2- CONVENTIONAL MORTGAGE

It is an advance provided via bank or mortgage broker, typically intended for the purchase of assets, where usury is imposed on the amount borrowed.⁴⁰

People typically opt for such mortgages to buy homes, repaying the loan amount provided by the bank along with the interest charged on it. If the homebuyer defaults on the loan, the bank has the right to take possession of the property.

“Some money today for more money tomorrow”⁴¹

The lender assumes no risk in the transaction, earning money solely from the loan without offering any additional services. People are often compelled to take out these mortgages to meet their housing needs.

3.3- MORTGAGE BANKS

Bank is a financial institution, dealing in money matters, having their branches etc., but there are some special banks called mortgage banks. Mortgage banks deal in real-estate loans.⁴²

Dealing of mortgage bank is different from a regular bank. Procedure of getting mortgage loan is not simple in regular bank; it does not accept loan application easily. But mortgage banks are very helpful in this regard. Some mortgage banks deal with public directly and some of them seek help of mortgage brokers.

3.4- MORTGAGE BROKER

Mortgage brokers are professionals, arrange loans for their clients. They actually, bridge the gape between the borrower and the lender.

Mortgage broker visit the market and arrange the best lender in accordance the borrower's needs.⁴³ They charge a fee for their services. These people are experts in originating mortgage loans and facilitate the whole process of mortgage loan, from finding of best lender, evaluation of credit situation, client's need till the repayment of mortgage loan. Some mortgage banks get the help of mortgage brokers.

3.5- *IJĀRAH* MORTGAGE

Ijārah is a contract of leasing property. Real-property or equipment may be leased by the contract of *ijārah*.⁴⁴

Ijārah mortgages are popular and flexible method of property finance as compare to *Murābahah*, because client or mortgager can repay the mortgage early and he can also make "over payments" to reduce the length of mortgage.⁴⁵

In *ijārah* mortgages length of mortgage may be reduced by the client or mortgager by paying additional payments of mortgage money. *Ijārah* (lease) contract shares many features with conventional mortgage.⁴⁶ Real property or equipments may be purchased by this contract.

Financial institution, under this contract, buys an asset according to the wish of client (lessee); who is prospective buyer of the asset. Bank or financial institution, then become the lessor and rent the property to the client/lessee for a specific time period.⁴⁷ An agreed amount of rent shall be paid by the lessee to the lessor/bank or in some cases, may receive a share of profit coming out of the asset.

There are two types of model⁴⁸ in *Ijārah* structure.

- i) *Ijārah wa iqtinah* (lease to own)
- ii) Simple *Ijārah*/Operating lease

In *ijārah wa iqtinah* (lease to own) structure of financing, lessee or client enter into two contracts with the bank or financial institution; "*ijārah* agreement" and "future purchase agreement"⁴⁹. In *ijārah* agreement, client being a lessee may use the leased asset for the time period fixed in lease agreement.

All the rules governing *ijārah* are applied under this contract. Bank or financial institution as a finance provider enters into a "promise to purchase" and "promise to sell" agreements with the client and purchase the asset, which is selected by the client. These contractual arrangements are coupled with lease agreement. Client or lessee pays monthly rent of the asset and an amount of capital borrowed.⁵⁰ Lessee pays the purchase price of asset in installments. Amount of rent is determined according to the prevailing market rates. When the lease term is completed or full payment of purchase price of the asset has been made, ownership of the property is transferred to

the lessee.⁵¹ Client or lessee gets the title of the property by paying off the purchase-price of the property, during the life of the mortgage.

This kind of leasing is normally, a long-term leasing, where title of property is transferred at the end of the term. It is very close to “modern finance lease”.⁵²

In **simple *ijārah*** contract, bank or financial institution leased an asset for a shorter-term. At the end of term, bank will retain the ownership of the asset. In *Ijārah* mortgage model bank or financial institution owns a property first, and then rent it out to the client thus, become lessor. Lessee client purchases the asset of bank or financial institution by paying purchase money in installments.

The purchase price of asset, for the client, will remain same as original purchase price paid by the bank/financial institution. Lease agreement between the client and the financial institution allows the client to get the possession of the asset and use or get benefit from it, during the term of lease-agreement. Amount of rent reduces by repayment of asset’s purchase-price in installment to the financial institution. Client or lessee attains the ownership by paying the full purchase-price of the asset.

Ijārah wa iqtinah (lease to own) is most common form of financing adopted by the Islamic financial institutions, although it has many similarities with conventional mortgages, but it is interest-free and there is no place for interest in Islamic finance. The amount of rent is re-assessed yearly and may be changed by the financial institution.

3.6- DIMINISHING *MUSHĀRAKAH* MORTGAGE

Diminishing *mushārahah* is a form of partnership and in case of Diminishing *mushārahah* mortgage, the bank or financial institution that is mortgagee and client/debtor/mortgagor jointly own a property.⁵³ The shares of bank or financial institution divided into a number of units. Mortgagor purchases the shares of bank periodically and at the end mortgagor become the sole owner of the asset.⁵⁴ A *mushārahah* mortgage is a form of *Ijārah* mortgage with shared ownership of the property.

Customer or prospective buyer or prospective asset’s owner and financial institution create joint-ownership based on the principle of “*Sharikah-al-Milk*”⁵⁵. A partnership agreement conducted between client and bank or financial institution. Then financial institution leases its shares to the client and charges an amount of rent for using the property because bank or financial institution is the owner of the particular share in the property.⁵⁶ Rental amount is jointly shared by the parties to the contract according to the percentage of each share-holder in the property. It keeps on changing as the client purchasing the shares of financial institution.

The share-ratio of client would increase by the time after each rental payment, because client is redeeming the bank's share periodically. At the end client or debtor/mortgagor become the owner of the property.

There are many Islamic financial institutions in the world, providing home-financing under the concept of Diminishing *mushārah*. Under this concept of home financing customer and financier/Islamic bank jointly provide investment for the purchase, construction and renovation of the property.⁵⁷ Bank's share is divided into units and given on rent to the partner or client, unit price of *mushārah* remains same without any change during the period of financing.⁵⁸ The profit rate is same as prevailing in the market.⁵⁹

Under the *Ijārah*(lease) agreement, client may use or get benefit from the property and pays a fair amount of rent/consideration to the bank(financier). *Mushārah* agreement, monthly payment agreement and a promise to purchase the *mushārah* unit, the property will be given as a continuing security to the bank or financial institution.⁶⁰ The client shall create a mortgage over the asset to secure the obligation⁶¹ of the client, from being default. The property itself serves as collateral to ensure the fulfillment of a promise or the repayment of a debt or obligation.

Some other models similar to “diminishing *mushārah* or *sharikah*” are also prevailing in practice of Islamic financial institutions like “declining participation in usufruct”⁶². Under that concept two rights of ownership given; one is ownership of title and other is right to use the property. Asset is purchased from the vendor by the client himself, acted as an agent of the financier and registers the title of the property on his name and thus become the owner of the title. Financial institution retains its share of usufruct, and then client offer to buy the share of financial institution and institution accept it and sells its share immediately at the same price. Sale price is repaid by the client in monthly installments over a period of up to 30 years. A lien or charge is created on the property in favor of financial institution. Income of the property is shared between client and financier proportionately.⁶³ When client/debtor pays back his debt or purchases the full shares of financial institution, he becomes the complete owner of the property. Repayment of loan is interest-free and rental value of property is determined according to the prevailing market rates.

3.7- MURĀBAHAH MORTGAGE

The original mortgage structure was based on *murābahah* contract.⁶⁴ It is widely practiced in United Kingdom and Middle East. *Murābahah* is a sale contract, where seller discloses to the buyer actual selling price plus all other expenses included in price, that are customarily not known to the buyer.⁶⁵

Murābahah is a sale contract like all the other sale contracts but it is different in respect of seller's disclosure of cost plus a specific percentage markup to the buyer. In case of "*murābahah* mortgage" where house finance is provided to the customer on the basis of deferred price of property plus an agreed amount of profit.

Murābahah is consist of two separate transactions; in first transaction Islamic mortgage provider purchase the property according to the wish of customer and then sell it to the customer at the cost plus a declared mark-up.⁶⁶ Selection of the property must be done, according to the wish and choice of the client, by the bank or mortgage provider. Islamic mortgage provider or bank purchases the property from the vendor directly then sell it to the client. Agreed amount of profit plus cost price of property is paid by the client to the Islamic mortgage provider in installments over a fixed period of time.⁶⁷ Ownership is transferred when all the agreed amount of price is paid that has become debt.

3.8- MUDĀRABAH MORTGAGE

Mudārabah mortgage model is currently, not very popular. *Mudārabah* structure is based on the practices of cooperative societies.⁶⁸ Islamic mortgage schemes are very popular in United Kingdom, United States of America and Canada because a large number of Muslims are residing there and most of them do not want to involve in any interest-based transaction to fulfill their housing needs. In United Kingdom initially, these *Sharī'ah* compliant mortgages were not very popular due to the levying of double stamp duty.⁶⁹ It was twice payable because purchase process completed in two stages: first purchase of property by mortgage provider from vendor and second purchase of property by the client from mortgage provider. Later on stamp duty was removed and it gave boost to the Islamic mortgage market in United Kingdom.

Interest rate in the conventional market is fluctuating all the time and this affects the Islamic mortgage market also. In order to compete with the conventional market, some Islamic mortgage provider makes changes in monthly installments. This would definitely, difficult to justify for a Muslim client and Islamic mortgage market could loose its identity as a result.

Some financial institutions are providing Islamic mortgages as well as conventional interest-based mortgages at the same time. Islamic mortgage providers borrow money from the open market to fund Islamic mortgages.⁷⁰

Apart from these facts, Islamic financial institutions consult Islamic scholars for the permissibility of their products. Every Muslim should confirm for his own satisfaction, that the particular product is really *Sharī'ah* compliant or not, before entering into the transaction.

3.9- MORTGAGES IN PAKISTAN

In Pakistan mortgages are not happened to be very popular. There are many types of mortgages in Pakistan like, home mortgages, commercial mortgages etc.⁷¹ poor and lower income groups in Pakistan could not get home mortgage finances, overseas private investment corporations and the Acumen fund are investing funds, that will enables the customer to release mortgages from the National Bank of Pakistan.⁷²

Mortgage facilities in Pakistan are not up to the mark and could not satisfy the needs of all people. Therefore, it is required to make reforms in mortgage schemes so that, all the Pakistanis whether living in country or abroad get benefit out of it. In the area of Islamic financial sector, Meezan Bank's "Easy Home" scheme was introduced. It was first Islamic home financing facility in Pakistan.⁷³

This facility is structured under the concept of *Mushārahah Mutanāqisah*.⁷⁴ Under this concept of home finance, bank and customer jointly own property. Now there are many other Islamic financial institutions offering *Sharī'ah* compliant products and schemes. So people in Pakistan are not forced to get conventional interest-based mortgages for housing or residential finance because *Sharī'ah* compliant house financing schemes is in practice. By these schemes not only house finance but equipment or other movable property can also be acquired.

4- ISLAMIC PAWN BROKING SCHEMES

Pawn broking is a method of lending by pawn shops in which fast and short-term cash⁷⁵ is provided to lower income groups or needy people to fulfill their problem of advance.

Pawn shops are providing short-term cash and successfully satisfying the problem of small scale traders to start their business. Loans or advances from banks tend to be expensive, making them unaffordable for individuals in low-income groups. Conventional pawn broking schemes are charging high interest rates and many other unIslamic elements are involved in them. So Muslims all over the world could not avail these facilities.

Islamic pawn broking schemes have been introduced by many Islamic financial institutions as an independent product. The countries like Indonesia, Malaysia etc., Islamic pawn broking products that are called "*Al-Rahnu*",⁷⁶ providing an alternate to interest-based conventional pawnshops and people are not bound to go to conventional pawnshops or financial companies to fulfill their need of cash or advance. *Rahn* means a pawn, pledge, mortgage or security. A pledge of security is provided to the creditor to safeguard the debt amount against potential default by the debtor. In this concept of *Al-Rahn* (Islamic pawn broking), debtor provides a pledge of

security in the shape of gold⁷⁷ or silver or embellishments made of gold to protect the repayment of balance due, to the creditor.

A pledge of security protects the loan amount from default by the debtor, and if the debtor fails to meet their obligations, the creditor has the right to sell the security to recover the debt. After entering into the contract of *rahn*, ownership of pledge asset is not transferred to the lender only possession is given. Ownership is transferred only under certain conditions.⁷⁸

4.1- PAWN BROKING HISTORY

Pawn broking is an ancient practice of lending. In this concept, money is lent on giving some valuable as security to protect the debt money from non-payment. Pawn broking can be traced back to 3,000 years in China's history and it has been found in early Romans, Greek and Islamic civilizations also.⁷⁹ Pawnshops were working under proper rules and principles in East as well as in West. Pawn brokers charged interest and it was against the teaching of Christianity. Those who were not Christian could easily avail that facility.

Christians although, took loans from Jews and Muslims on interest but criticized them at the same time for doing so. Many Jews were targeted and punished in money lending cases in the western history. The Medicis⁸⁰, played an important part in making modern banking, accounting, pawnshop lending and other financial operations.⁸¹

By the time, church modernized its teaching in money and finance related issues, usury was considered a sin but now it was acceptable. By taking such measures image of the bank has been improved.

Pawnshops could not improve their image so far. Even today, they are facing reputation problem and considered exploitative toward poor and being involved in criminal activities. Nowadays, there are many other lending facilities are available due to the reason pawnshops are losing their popularity as a short-term loan provider. But still they have a longer history than that of a traditional bank, and have an ability to prove to be the best option in personal lending.

4.2- SIGNIFICANCE OF COLLATERAL

Collateral or security plays an important role in financial transactions. It gives confidence to the seller or creditor that his money would not be lost and thus, encourage the people to give more and more advance or cash to the needy. *Qur'ān* also supports *rahn* against a debt.⁸² Collateral in the form of movables or immovable may be taken to secure the amount of debt. Allah says in this *Qur'ānic* verse:

“Every soul is in pledge for its deeds”⁸³ .

Holy prophet (peace be upon him) said that the soul of a believer is pledged for the debt until it is paid off.⁸⁴

Under this concept of Islamic pawn broking system, short-term loan is given by Islamic financial institutions on providing collateral in shape of gold, silver, diamond, vehicles and other movables. Small scale-traders and people with low income may easily get cash or advance through this system because conventional banks are giving credit facility to those, who can furnish heavy security. Beside that, conventional banking system charges high rate of interest, in fact they are catering large income groups or big enterprises.

There is a need to bridge the gap between small and large income groups and many good firms or enterprises may need finance to start or establish their business, but due to the heavy collateral requirement, could not get finance or advance. Collateral must be adequate in accordance with the amount of debt so that both rich and poor fulfill their need of cash.

Some Islamic financial institutions like Muslim Funds in India, are accepting collateral only in shape of gold or silver.⁸⁵ The value of the security is not the primary concern, but it must exceed the amount of the debt. They take such types of collateral to avoid problem of default or breach of contract.

Safety of collateral or security itself is a big issue for the financial institutions. They need to have their own lockers etc., to make sure the safety and security of collateral.

4.3- FEATURES OF ISLAMIC PAWN BROKING SYSTEM

Islamic Financial institutions offer a wide range of services plus products to the Muslim customers such as *mushārahah*, *mudārahah*, *murābahah*, *ijārah*, *kafālah*, *wakālah*, *qard*, *rahn*, *bay' bithaman ajil*, *salam*, *istisnā'*, etc. In practice Islamic financial institutions are usually dealing only in *mushārahah*, *mudārahah*, *murābahah* and *bay' bithaman ajil* products.⁸⁶ Other products and services like *rahn* etc., are not very popular because people may have some doubts about the legality of these products.

Islamic financial institutions should take step to introduce other products like *rahn* as an independent product and make the things acceptable for the Muslim customers, remove their doubts by conducting more and more research in this field of Islamic economics and finance. Islamic pawn broking concept is based on following things⁸⁷:

- a) Benevolent Loan (*Qardhul Hasan*)
- b) Trustworthiness (*Wadī'ah Yadul Amānah*)
- c) Safekeeping with guarantee
- d) *Mudārahah*

a) **Benevolent Loan (*Qarḍul Ḥasan*)**

A benevolent loan will be granted to the client by the financial institution and he will pawn his valuable asset to the institution.⁸⁸ Under the concept of benevolent or interest-free loan, debtor pays back the same amount of loan to the creditor and then redeem back his valuable.

Normally, these types of loans are taken to fulfill urgent needs, so it has an element of need fulfillment and at the same time valuable asset will act as a security to secure the amount of creditor.

b) **Trustworthiness (*Wadī'ah Yadul Amānah*)**

Debtor pawns valuable asset to the creditor or financial institution as a security to secure the amount of debt. Pawn object belongs to the borrower but entrusted to the creditor as a security and he is responsible to take care of it. If pawn object is damaged without the negligence of creditor then he is not responsible to compensate or replace the pawn object.

c) **Safekeeping (*Al-Ujrah*) with guarantee**

Islamic financial institution keeps the pawn object in safe and good condition and charge a fee for these services. The valuable articles are taken under the concept of *wadī'ah*.⁸⁹ Institutions make sure the safety of valuable by providing proper security and insurance. Bank or financial institution returns back the asset to the owner when debt is fully paid. In the event of carelessness or misconduct by the lender or bank, he will be responsible to compensate the debtor otherwise, lender is not responsible for any loss or damage to pawn object.

d) ***Mudārabah***

Mudārabah can be used in Islamic pawn broking system with benevolent loan. Under this concept pawned goods or objects utilized for investment or productive purposes.⁹⁰ Lender and borrower will share profit according to the agreement.

Islamic pawn broking schemes are beneficial because they are *Sharī'ah* compliant and an alternative to interest-based conventional pawn broking system. It is quick and easier way of getting advances and relatively cheap than conventional pawn broking, with longer financing tenure and fixed storage fee.

If the pawned item is sold for more than the amount of the debt, any excess amount is returned to the borrower. Islamic financial institutions need more funds to build place for storage to store the mortgaged or pawned objects.

Therefore, Islam emphasizes on the helping of needy or poor and encourages giving them loans. The concept of benevolent loan is also based on this notion of need fulfillment.

Allah says:

إِنْ تَقْرَضُوا اللَّهَ قَرْضًا حَسَنًا يُضَاعِفْهُ لَكُمْ

“If you offer up to Allah a goodly loan. He will amply reply it”⁹¹.

Any increase on repayment of loan is amount to *ribā* and declared unlawful. Loan under Islamic law is gratuitous one no increase or reward is acceptable. But repayment of a loan may be guaranteed by way of *rahn*.

Islamic pawnshops are providing short-term money to lower-income group to fulfill their immediate need of cash. In today's context, the significance of cash cannot be overlooked, not only for business purposes' but also for festivals, marriages or medical expenses etc.

As we know, conventional financial system is based on interest or usury that is completely forbidden in Islam. Conventional pawnshops are giving credit facility and charging high rates of interest. Loans provided by conventional banking system are very costly and lower income-group cannot afford it. So there is a need to bridge the gap between rich and poor, for doing so, cheap loans should be offered by the financial institutions to facilitate lower-income groups. Interest is the back-bone of conventional financial system; it can only exploit the poor and cannot really bring any positive change for them.

Islamic financial institutions introduced many *Sharī'ah* compliant products, *rahn* is also provided by them as an additional guarantee and as an independent product also. Financial assistance is being provided by financial institutions in some countries to needy or lower-income group.⁹² These institutions accept security in shape of gold and jewelry from debtor to protect the debt money against non-payment.⁹³ No interest is charged only safe-keeping charges are allowed.

Islamic pawn broking providing cash with low cost and accept security only in shape of gold or gold jewelry.⁹⁴ Amount or value of collateral must be greater than the amount of advance. In case of default, institution sells the pawn object and any extra amount coming out of sale proceeds will be given back to the borrower. These pawn broking schemes are very attractive for Muslims because they are based on *Sharī'ah* principles. Method of getting loan is much easier than the other financial institutions. No extra fee or duty is levied and process is very quick, term of credit can also be extended.⁹⁵

There is a great need to make reforms in this system of lending to make it fully *Sharī'ah* compliant. Many Muslim scholars having objections on the application of such products, for example service charges levied on gold or ornaments are not fully approved by them.⁹⁶

The pledged asset is crucial within pawn broking projects. If it is limited solely to gold, it becomes challenging in favor of individuals in lower-earning groups to access these loans. Financial institutions should accept live stocks, vehicles, silver, watches and other things to make the scheme acceptable for masses.

Conventional pawn broking shops are providing various products and services some of them are very low cost and convenient apart from that, many illegal money lenders are also actively working in the market. So there is a need to conduct more and more research in the field of Islamic pawn broking or *rahn* to make it fully *Sharī'ah* compliant then it would be able to compete all the illegal, unfair and interest-based practices.

5- Conclusion & Recommendations

Islam serves as a comprehensive code of life, offering distinct principles and rules that govern all aspects of human existence. It emphasizes justice, fairness, brotherhood, and equity, asserting that any society lacking these values cannot be considered truly human. Islamic mortgages are increasingly popular, especially in Western countries, providing alternatives to conventional, interest-based mortgages, which are prohibited in Islam. These *Sharī'ah* compliant financing solutions aim to meet housing needs while adhering to Islamic ethical standards.

To implement genuine Islamic financial mechanisms, significant reforms are necessary within financial institutions and the state. Islamic financial organizations ought to evolve exclusive benchmarks for determining income or pricing, independent of conventional interest rates, to better navigate open market circumstances. Rental values should reflect the actual market value of properties rather than existing interest rates. Institutions must create a leasing or house price guide based on current market values. The principles of profit and loss sharing must be upheld, ensuring that any fluctuations in property values are equitably shared among partners. This necessitates actual transactions and a strict avoidance of *ribā*, *gharar*, *qimār*, and other unfair practices. Islamic pawn broking offers a viable alternative to conventional pawnshops. These reforms are crucial for fostering an authentic Islamic financial environment.

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